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Statement No. 237

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Statement of the Shadow Financial Regulatory Committee on
Shareholder Access to Director Elections
December 4, 2006

At a meeting scheduled for December 13, the SEC has indicated that it will discuss the implications of *AFSCME Employees Pension Plan v. AIG*, a 2nd Circuit Court of Appeals decision in September 2006. In that case, the court held that AIG could not exclude from its proxy statement a shareholder-proposed bylaw amendment that would allow shareholders (owning at least 3% of the outstanding shares) to nominate candidates for election to AIG's board who would be included in the company's proxy statement. This is a variant of the shareholder access proposal that the SEC published in 2003 but has never acted on, and that the Shadow Financial Regulatory Committee criticized in Statement No. 199 (December 8, 2003).

The Committee believes there would be considerable potential benefit for the economy if shareholders were able more easily to elect directors who are committed to better corporate performance, but not if the result would merely be to facilitate the use of the election process by small groups of shareholders more interested in promoting their personal causes than in enhancing the value and performance of the firm.

The Committee believes that the fundamental purpose of shareholder voting is to enable shareholders to take control of corporate boards and change management when and if they are dissatisfied with corporate performance. This process would be facilitated by lowering the transaction costs (that is, proxy solicitation expenses) associated with an effort to elect a majority of the directors of a corporation.

Accordingly, shareholders owning a substantial portion of the firm's equity (say 10-20%) could signal their position by presenting, and voting for, an access bylaw similar in form to the AFSCME proposal. If the bylaw were adopted, it could permit a substantial percentage of outstanding shares (say, 20-30%) to present a slate of nominees for at least a majority of the seats on the corporation's board that are to be filled at the next annual meeting. In this case, the corporation would have an option, either to include this slate in its own proxy materials or to pay for the preparation and distribution to shareholders of a proxy statement for the contesting group.

Thus when the SEC discusses the structure of its proxy rules, as the 2nd Circuit invited, we encourage it to frame the issue in terms of enhancing the ability of shareholders to oust ineffective managements rather than allowing shareholders with special interests to elect one or two directors to a corporation's board.

The issue presented by the AFSCME case is only one part of the larger issue of effective corporate governance, which involves questions such as the proper role of poison pills, staggered boards, Williams Act provisions and the like. The Interim Report of the Committee on Capital Markets Regulation presents proposals in this area which we intend to discuss at our next meeting.